

The Commonwealth of Massachusetts

Office of the Comptroller

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To the Citizens of the Commonwealth of Massachusetts,
Governor William F. Weld, and Honorable Members
of the General Court:

The cover and artwork throughout this document depict momentous historical events, such as the famous ride of Paul Revere, that have occurred in Massachusetts. From the perspective of state finance, the fiscal year ended June 30, 1995 (FY95) is also noteworthy. The Commonwealth will report for the first time since it started measuring financial conditions under generally accepted accounting principles (GAAP) a positive fund balance in its Budgeted Funds. For the fourth consecutive year revenues have exceeded expenditures by a significant amount, and a large portion of liabilities created in past years has been funded. The financial condition of the Commonwealth, on a GAAP basis, is very good.

The Office of the Comptroller is responsible for the fair presentation of the financial statements of the Commonwealth and for the preparation of this Comprehensive Annual Financial Report (CAFR) which is presented in three sections: Introductory, Financial and Statistical. The three sections of the CAFR, as detailed in the table of contents include the information necessary for the reader to obtain a comprehensive understanding of the Commonwealth's financial position and the results of its operations for FY95.

The CAFR is prepared in accordance with GAAP as established by the Governmental Accounting Standards Board (GASB), the professional standards of the American Institute of Certified Public Accountants (AICPA), the recommendations of the Government Finance Officers Association (GFOA), and the requirements of state finance law.

The implementation of GASB statement No.10 Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, had a material impact on the FY95 CAFR.

The following GASB statements while effective in FY95 did not materially change CAFR presentation because Commonwealth accounting policies already conformed to the requirements:

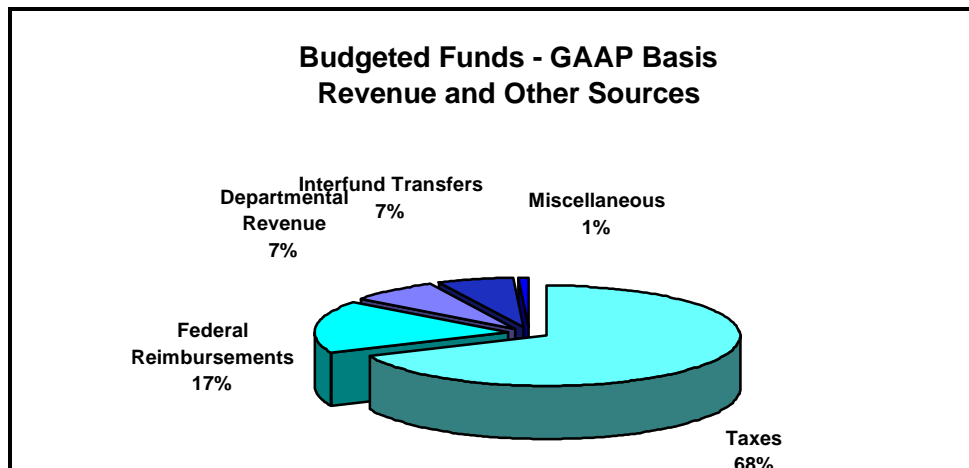
- statement No.19 Government College and University Omnibus Statement (Risk Financing Activities);
- statement No.20 Accounting and Financial Reporting for Proprietary Funds and Other Entities that use Proprietary Fund Accounting;

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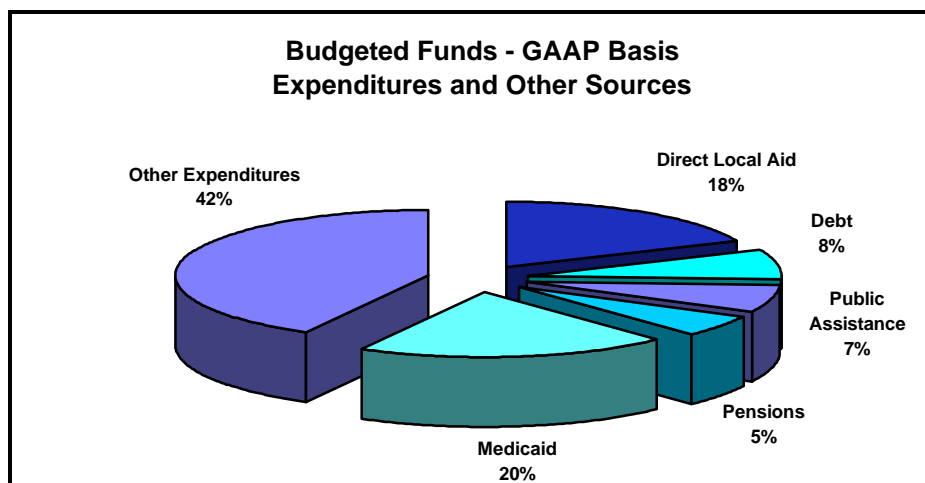
- statement No.21 Accounting for Escheat Property; and,
- statement No.22 Accounting for Taxpayers Assessed Tax Revenues in Governmental Funds.

The portion of state finances that typically engenders the highest degree of interest is the Budgeted Funds. These include the General, Local Aid, Highway, and Other Funds which comprise the annual state budget.

In FY95 revenues and other sources totaled \$ 16,517.7 million. The chart below shows the percentage of revenue by type contributing to that total.



Budgeted funds expenditures and other uses totaled \$ 16,249.1 million in FY95. The chart below depicts the percentage of each major program in this total.



The tables which follow set forth a multi-fiscal year view of financial performance for the Budgeted Funds under GAAP, and also provide a comparison to the same funds as accounted and reported under the statutory basis of accounting.

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BUDGETED FUNDS OPERATIONS - GAAP BASIS

(Amounts in millions)

	<u>FY91</u>	<u>FY92</u>	<u>FY93 *</u>	<u>FY94</u>	<u>FY95</u>
Beginning fund balances (deficits)	\$ (1,895.5)	\$ (761.2)	\$ (317.4)	\$ (184.1)	\$ (72.0)
Equity transfer					<u>91.0</u>
Restated beginning balance	<u>(1,895.5)</u>	<u>(761.2)</u>	<u>(317.4)</u>	<u>(184.1)</u>	<u>19.0</u>
Revenues and other financing sources	14,099.7	14,129.7	15,181.0	15,804.9	16,517.5
Expenditures and other financing uses	<u>14,328.1</u>	<u>13,765.9</u>	<u>15,047.7</u>	<u>15,692.8</u>	<u>16,249.1</u>
Excess (deficiency)	(228.4)	363.8	133.3	112.1	268.4
Prior year deficit financing	<u>1,362.7</u>				
Ending fund balances (deficits)	\$ <u><u>(761.2)</u></u>	\$ <u><u>(397.4)</u></u>	\$ <u><u>(184.1)</u></u>	\$ <u><u>(72.0)</u></u>	\$ <u><u>287.4</u></u>

*As restated to reflect discrete presentation of the University and College Fund

On the statutory basis of accounting, which is used to develop the Commonwealth's budget and control its daily activities, the Budgeted Funds have achieved positive ending fund balances for each of the last five years.

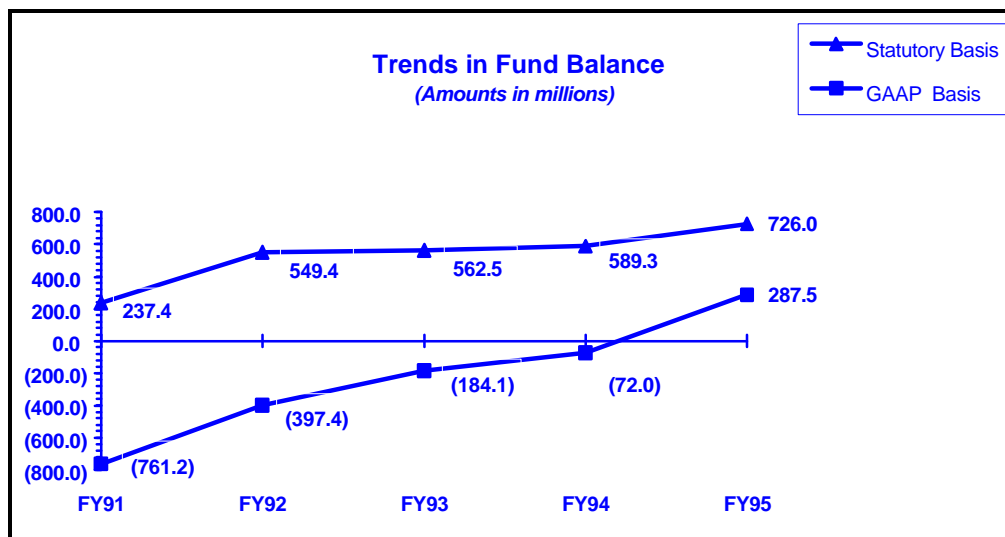
BUDGETED FUNDS OPERATIONS - STATUTORY BASIS

(Amounts in millions)

	<u>FY91</u>	<u>FY92</u>	<u>FY93</u>	<u>FY94</u>	<u>FY95</u>
Beginning fund balances (deficits)	\$ <u>(1,104.4)</u>	\$ <u>237.1</u>	\$ <u>549.4</u>	\$ <u>562.5</u>	\$ <u>589.3</u>
Revenues and other financing sources	14,493.3	14,226.1	15,205.7	15,979.2	16,930.8
Expenditures and other financing uses	<u>14,514.5</u>	<u>13,913.8</u>	<u>15,192.6</u>	<u>15,952.4</u>	<u>16,794.1</u>
Excess (deficiency)	(21.2)	312.3	13.1	26.8	136.7
Prior year deficit financing	<u>1,362.7</u>				
Ending fund balances	\$ <u><u>237.1</u></u>	\$ <u><u>549.4</u></u>	\$ <u><u>562.5</u></u>	\$ <u><u>589.3</u></u>	\$ <u><u>726.0</u></u>

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Over the past four years the Budgeted Funds on a statutory basis have reported operating gains, increasing fund balance from \$237.4 million to \$726.0 million for a cumulative improvement of \$488.6 million. Over the same period on a GAAP basis, operating gains have improved fund balance from a deficit \$761.2 million to a positive \$287.5 million, with cumulative improvement of \$1,048.7 million. Simply stated, widely acknowledged efforts to accomplish fiscal balance on a statutory basis are even more impressive when viewed on a GAAP basis.



The basic principle of GAAP is to match inflows pertaining to the fiscal year to outflows for the same period to demonstrate if the objective of interperiod equity was accomplished. A modified accrual basis of accounting is employed to recognize certain assets and liabilities. Accomplishment of interperiod equity is denoted in a positive fund balance, and the failure to accomplish that goal is shown as a fund deficit. The effect of fund deficits shifts the burden of funding expenditures incurred in prior years to taxpayers in future years. The Commonwealth has provided not only revenues to match expenditures in the current year, but also excess revenues to “catch up” on prior year deficits.

There are five major items that account for almost all the difference between the statutory basis reporting and GAAP: Medicaid, subsidies to transit authorities, compensated absences, claims and judgments, and tax revenues.

For the Medicaid program, expenditures under the statutory basis of accounting are equivalent to cash disbursements. Thus bills for services rendered in the fiscal year but not paid, or rate adjustments owed but not paid are not measured in that year, but “pushed” into the next fiscal year. Under GAAP such items are accrued, so that all expenditures are consistently correlated to the fiscal year to which they pertain. The Medicaid expenditures measured on a GAAP basis for FY95 were \$3,252.2 million, which is 1.1% higher than FY94. This very small increase is noteworthy, especially since total budgeted expenditures increased 3.8% from FY94 to FY95. It is apparent that initiatives implemented by the Division of Medical Assistance are constraining Medicaid growth to amounts less than the total budget, thus helping to balance the overall budget.

A second item is the amount the Commonwealth will owe for subsidies to the Massachusetts Bay Transportation Authority (MBTA), the Regional Transit Authorities (RTAs), and the Massachusetts

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Convention Center Authority. Through various laws the Commonwealth has obligated itself to provide subsidies to these component units for operations and debt service. However, the annual budget is appropriated on a basis which "lags" behind the total amount of the subsidy. Under GAAP this amount is accrued, so that the total obligation is measured. For many years the amount for the "not yet appropriated" subsidy was growing at rates higher than the total budget. However in recent years this trend has reversed, and in FY95 the amount accrued for subsidy obligations not yet appropriated decreased from FY94 by \$42.0 million.

The third item is compensated absences. Under GAAP the amounts owed for vacation earned but not yet taken and certain amounts of sick leave are accrued and reported as expenditures of the fiscal year. The trend for compensated absences has been relatively consistent.

The fourth item is claims and judgments. This has three components. One component relates to lawsuits. Under the statutory basis, amounts owed in lawsuits for torts, tax disputes, eminent domain land taking, or other legal actions are not measured as expenditures until the lawsuit is decided and the settlement is actually paid. Under the GAAP basis an analysis is performed on all litigation, and an amount is accrued for that portion of litigation where a settlement against the Commonwealth is considered probable. With efforts by the Office of the Attorney General to resolve litigation successfully and timely, the amount of this accrual has been gradually decreasing.

The second component of claims and judgements relates to Group Health Insurance. The Commonwealth's indemnity health plan allows payments for certain claims incurred in a prior year, the bills for which may not be rendered until the ensuing fiscal year. As with Medicaid, an analysis is performed and an amount is accrued. For the past five years the trend for the Group Health Insurance accrual has been relatively consistent.

The third component of claims and judgements relates to the Worker Compensation Program for Commonwealth employees managed by the Public Employee Retirement Administration (PERA). Under the statutory basis of accounting, expenditures for workers compensation benefits and medical expenses are recognized when paid. However, like Medicaid and Group Health, claims may be incurred and the payments may not transpire until an ensuing, fiscal year. Several initiatives have been implemented which have reduced the GAAP accruals by tens of millions of dollars. Since FY93, workers compensation losses have been charged back to the respective state department, thus providing an incentive for agencies to control costs and improve safety programs. Also legal advice and assistance was transferred by the Attorney General to individual agencies and a new special unit in the Executive Office of Administration and Finance. This transfers legal activity closer to those who have direct knowledge of the worker and direct stake in returning the worker to the job. PERA has been very active in the implementation of legislation and other actions to control the program. For example PERA increased staff to stabilize case loads and increased case management of medical claims including full utilization reviews. Also PERA has implemented recent statutory authority to remove workers from the worker compensation rolls within the first 180 days of disability when, in PERA's judgment, workers are capable of returning to work. In addition PERA has utilized lump sum payments to settle older claims, resulting in significant future economic savings. Generally PERA has provided leadership to all state agencies, to better manage the state employee worker compensation program, and the decreased GAAP accrual is evidence of PERA's success.

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The fifth item that explains the difference between statutory and GAAP relates to tax revenue. For several reasons, for example, the extension of an income tax return, a taxpayer's obligation incurred in a fiscal year might not be fully collected until the ensuing fiscal year. Under GAAP a special analysis is conducted in conjunction with the Department of Revenue (DOR), and an accrual for revenue is computed. The value of accrued revenue increased by \$98.5 million in FY95, suggesting improvements in both the underlying economy and the efficiency of tax administration by DOR.

INDEPENDENT AUDIT

The firm of Deloitte & Touche LLP, together with subcontractors Daniel Dennis & Company, Margaret Carr, CPA and Susan Perna-Damon, CPA, and assisted by the Office of the State Auditor, have performed an independent audit of the Commonwealth's general purpose financial statements for the fiscal year ended June 30, 1995. We express our thanks to the staff of the respective firms for their professionalism, advice and counsel. FY95 marks the tenth consecutive year that the financial statements have been reported upon by independent auditors. Their report is presented in the Financial Section.

INTERNAL CONTROL ENVIRONMENT

Massachusetts law, Chapter 647 of the Acts of 1989, places authority and responsibility for internal controls with the head of each executive department, constitutional office, and branch of government. The Office of the Comptroller issues internal control guidelines and the Office of the State Auditor may investigate departments with risk of internal control weaknesses. The two Offices have continued to deliver joint training sessions for department managers regarding their responsibility for internal control in the Commonwealth's highly computerized environment.

Absolute internal control assurance is prohibitively expensive. Using risk assessment criteria set forth in the guidelines and stressed in the training, the objectives of the Commonwealth's internal control structure are to provide management and the public with reasonable assurance that internal control systems do not have material weaknesses. The reader is referred to the separately published Commonwealth Single Audit and the report of the independent auditors for additional information on internal controls.

REPORTING ENTITY

The financial statements incorporate the fiscal activities of 154 departments, agencies, boards, commissions, institutions of higher education, the judicial and legislative branches of government, and constitutional offices. These departments record their daily financial operations in the state accounting system called the Massachusetts Management Accounting and Reporting System (MMARS), operated by the Office of the Comptroller.

In addition, the financial statements include independent public authorities, and the State Employees' and Teachers' Retirement Systems. These component units meet the GAAP criteria for inclusion in the reporting entity, which are further described in Note 1 to the general purpose financial statements.

ACCOUNTING SYSTEM AND BUDGETARY CONTROL

MMARS is the computerized, statewide accounting system used by all departments to control and account for their financial activity under the statutory basis of accounting. The financial operations of the

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authorities and certain non-appropriated higher education funds are accounted for through their own independent accounting systems.

MMARS is designed to satisfy all requirements of the Commonwealth's statutory basis of accounting and financial reporting. Any additional information needed to prepare financial statements according to GAAP is provided through a combination of MMARS system-generated data, information compiled by departments and the submission of audited financial statements from certain independent authorities.

Note 2 to general purpose financial statements provides a reconciliation between the General and Budgeted Special Revenue Funds on a statutory basis and the GAAP basis presented in the general purpose financial statements.

GOVERNMENTAL FUND OPERATIONS

Within the Governmental Fund Types are the General Fund, Special Revenue Funds (many of which are budgeted), and Capital Projects Funds. These funds portray the Commonwealth's comprehensive governmental financial activity. The five-year trend of operations, on a GAAP basis, is summarized in the following table:

<u>GOVERNMENTAL FUND OPERATIONS</u> <i>(Amounts in millions)</i>					
	<u>FY91</u>	<u>FY92</u>	<u>FY93*</u>	<u>FY94</u>	<u>FY95</u>
Beginning fund balances (deficits)	\$ <u>(1,595.0)</u>	\$ <u>(764.3)</u>	\$ <u>(416.8)</u>	\$ <u>(478.3)</u>	\$ <u>(273.70)</u>
Equity Transfer					<u>15.5</u>
Restated beginning balance	<u>(1,595.0)</u>	<u>(764.3)</u>	<u>(416.8)</u>	<u>(478.3)</u>	<u>(258.2)</u>
Revenues and other financing sources	20,217.5	20,795.5	22,380.3	23,226.0	24,216.4
Expenditures and other financing uses	<u>20,749.5</u>	<u>20,278.9</u>	<u>22,441.8</u>	<u>23,021.4</u>	<u>23,974.5</u>
Excess (deficiency)	(532.0)	516.6	(61.5)	204.6	241.9
Prior year deficit financing	<u>1,362.7</u>				
Ending fund balances (deficits)	\$ <u><u>(764.3)</u></u>	\$ <u><u>(247.7)</u></u>	\$ <u><u>(478.3)</u></u>	\$ <u><u>(273.7)</u></u>	\$ <u><u>(16.3)</u></u>

* As restated to reflect discrete presentation of the University and College Fund.

Within the Capital Projects Funds component of the Governmental total, the Commonwealth issued approximately \$476 million more in project financing in early FY96 instead of late FY95. Had such capital project financing been issued in FY95 the Governmental Funds would report a positive fund balance.

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FIDUCIARY FUND OPERATIONS

The Fiduciary Fund Types include the Expendable Trust, Non expendable Trust, Pension Trust and Agency Funds.

The Non expendable Trust Fund and the Agency Funds account for assets held with restrictions and assets held temporarily on behalf of other parties. The amount of such assets managed by the Commonwealth increased by \$509 million during FY95, to \$5.5 billion.

The Expendable Trust Funds ended FY95 with a fund balance of \$780.4 million composed of a balance of \$131.3 million in Expendable Trusts and \$649.1 million in the Unemployment Compensation Fund.

The Commonwealth is responsible for the payment of pension benefits for its employees and for the teachers of the cities, towns and regional school districts. It manages the operations of both the State Employee's Retirement System (SERS) and Teacher's Retirement Systems (TRS), and the Pension Trust Funds report the results of their operations and net assets available to fund pension benefit obligations in the Pension Trust Funds.

Pursuant to the pension reform law effective in FY88, the Commonwealth is funding its unfunded pension liabilities on a 40-year funding schedule. It is the responsibility of the Public Employee Retirement Administration (PERA) to complete actuarial updates for the funding schedule.

PERA has published an actuarial report as of January 1, 1995 for SERS, and TRS and for State Boston Retirement System (SBRS). These reports when applied to the measurement of the pension funding status as defined by GAAP yield the following:

<u>PENSION FUNDING STATUS</u>					
<i>(Amounts in millions)</i>					
	<u>FY91</u>	<u>FY92</u>	<u>FY93</u>	<u>FY94</u>	<u>FY95</u>
Total pension benefit obligation	\$ 18,599	\$ 17,640	\$ 19,476	\$ 20,670	\$ 19,632
Net assets available for benefits	<u>8,439</u>	<u>9,825</u>	<u>10,584</u>	<u>12,201</u>	<u>12,331</u>
Unfunded pension benefit obligation	<u>\$ 10,160</u>	<u>\$ 7,815</u>	<u>\$ 8,892</u>	<u>\$ 8,469</u>	<u>\$ 7,301</u>
Percent Funded	<u>45%</u>	<u>56%</u>	<u>54%</u>	<u>59%</u>	<u>63%</u>

Additional information on the retirement systems is presented in Note 10 to general purpose financial statements.

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UNIVERSITY AND COLLEGE FUND TYPE

Since FY93 the CAFR has presented the University and College system in accordance with the AICPA Industry Audit Guide "Audits of Colleges and Universities". This presentation combines financial activity from all fund types for:

- The University of Massachusetts, including its campuses at Amherst, Boston, Dartmouth, Lowell, Worcester Medical School, and the Teaching Hospital, Group Practice and Building Authorities,
- the State College System of nine state colleges, which provide four year post-secondary education, and the State College Building Authority, and
- the Community College system of fifteen community colleges which provide two-year post-secondary education programs.

<u>UNIVERSITY AND COLLEGE FUND TYPE OPERATIONS</u> (Amounts in millions)			
	<u>FY93</u>	<u>FY94</u>	<u>FY95</u>
Beginning fund balances	\$ <u>1,991.6</u>	\$ <u>2,010.4</u>	\$ <u>2,034.9</u>
Revenues and other additions	1,329.2	1,449.5	1,536.7
Expenditures and other deductions	1,881.3	2,006.4	2,082.0
Net transfers, including state appropriations	<u>570.9</u>	<u>581.4</u>	<u>601.6</u>
Net Increase (decrease)	<u>18.8</u>	<u>24.5</u>	<u>56.3</u>
Ending fund balances	\$ <u><u>2,010.4</u></u>	\$ <u><u>2,034.9</u></u>	\$ <u><u>2,091.2</u></u>

The University and College Fund Type reports a positive GAAP fund balance. Approximately \$2.0 billion of this fund balance is restricted or designated in plant funds, endowment funds, or other purposes.

COMPONENT UNITS

The Commonwealth's relationship to the independent public authorities, reported as Component Units, is based on statute and contracts between the Commonwealth and these entities.

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<u>COMPONENT UNITS OPERATIONS</u>					
<i>(Amounts in millions)</i>					
	<u>Beginning Retained earnings</u>	<u>Operating gain/ loss</u>	<u>Subsidy</u>	<u>Other changes</u>	<u>Ending Retained earnings</u>
Massachusetts Bay Transportation Authority	\$ (166)	\$ (561)	\$ 557	\$ (42)	\$ (212)
Regional Transit Authorities	2	(72)	50	22	2
Water Pollution Abatement Trust	7	(6)	3	13	17
Massachusetts Convention Center Authority	(4)	(13)	20	(5)	(2)
Bay State Skills Corporation	1	(9)	6	3	1
Government Land Bank	25	(5)	6	2	28
Massachusetts Community Development Finance Agency	2	(1)	1	(2)	0
Massachusetts Technology Park Corporation	19	(1)	2	1	21
Community Economic Development Assistance Corporation	30	0	6	0	36
Massachusetts Corporation for Educational Telecommunication	4	(10)	6	4	4
Massachusetts Industrial Service Program	13	(34)	1	39	19
Massachusetts Housing Partnership	15	1	2	(3)	15
Massachusetts Zoological Corporation	(1)	(2)	3	0	0
Massachusetts International Trade Council	0	(1)	1	0	0
Total	<u>\$ (53)</u>	<u>\$ (714)</u>	<u>\$ 664</u>	<u>\$ 32</u>	<u>\$ (71)</u>

CASH AND INVESTMENTS

Cash and investments are controlled by the State Treasurer. Each department transmits all cash receipts to the Treasurer's Office. Weekly and daily warrants for disbursements are prepared by the Comptroller, and reviewed and approved by the Governor's Council; disbursements are issued by the Treasurer. A major project is underway to streamline the banking and disbursement process, and maximize use of electronic funds transfer.

A system of bank depository and disbursement accounts and lockboxes is employed by the Treasurer's Office to maximize daily cash balances. The Treasurer manages these cash balances in pooled investment funds to optimize interest earnings. The Treasurer's Office invests cash from these general

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accounts in short-term securities and other investments. A discussion of cash and investments is presented in Note 3 to general purpose financial statements.

The Treasurer is also responsible for quarterly cash flow plans, weekly variance reports, and, jointly with the Executive Office for Administration and Finance, annual and quarterly cash management plans. Taxes and non-tax inflows, warrants, other outflows, and short and long-term borrowings are monitored against these plans.

FY95 is the second year of the Commonwealth implementation the US Cash Management Improvement Act (CMIA). The CMIA requires the states to measure interest income on federal funds drawn from the US Treasury prior to disbursement, and for the US Treasury to measure interest income on funds drawn down subsequent to disbursement. A settlement of interest due to or due from the state and federal government is computed. For FY95 the net settlement is an immaterial amount.

DEBT

The Commonwealth funds its capital appropriations by authorizing the issuance of long-term bonds. The following table sets forth the trend of the Commonwealth's tax supported long-term indebtedness for the last five years:

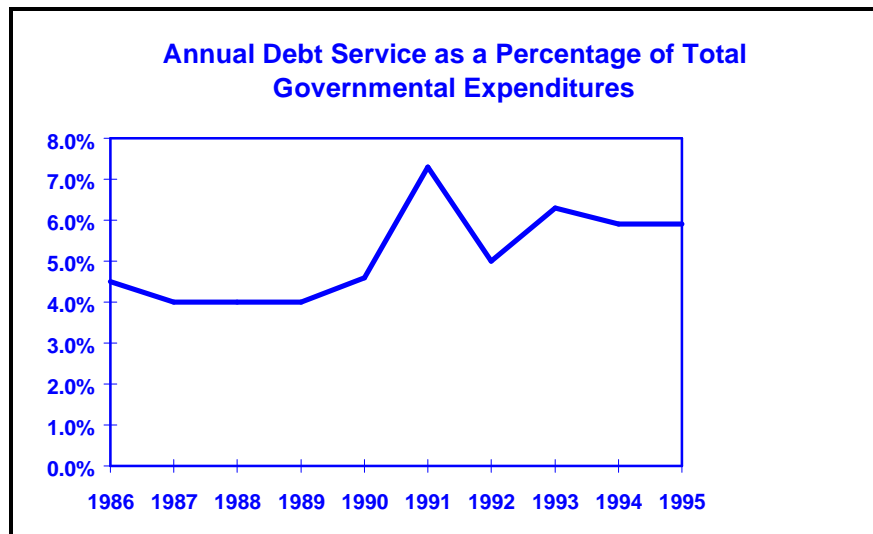
<u>LONG-TERM DEBT</u> <i>(Amounts in billions)</i>		
<u>Fiscal Year</u>	<u>Authorized - unissued</u>	<u>Principal amount of outstanding long-term debt</u>
1995	5.9	9.6
1994	4.5	9.4
1993	4.6	9.2
1992	4.9	8.6
1991	4.9	8.6

Approximately \$620 million of the bonds outstanding represent borrowing to finance the statutorily defined FY90 deficit. This authorization requires complete repayment by FY98. During FY95, to take advantage of favorable changes in interest rates, the Commonwealth refunded approximately \$463 million in outstanding debt. This action created a net economic gain of \$21 million.

In addition to long-term debt, the Treasury may issue small denomination minibonds to finance capital projects. These bonds have a maximum term of 5 years, but, because they may be redeemed by the holders at any time, they are accounted for as fund liabilities. No new minibonds were issued and all previously issued minibonds have been retired.

To limit the Commonwealth debt burden, and control the degree to which debt service creates pressure on the operating budget, the Administration has implemented a five year capital spending plan. This administrative policy has been in effect for several years, and the effect of debt service on the operating budget is depicted on the following table.

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As authorized by state finance law, the State Treasurer may utilize short-term borrowing to support governmental cash flow. As a sign of the improved financial condition, no revenue anticipation notes for cash flow purposes were issued in FY95.

Other debt consists of certificates of participation and capital lease agreements. Such financing arrangements are used to acquire capital assets, for example computer equipment and motor vehicles. The Commonwealth continued to utilize this form of financing in FY95.

Additional information on Commonwealth debt including guaranteed debt of independent public authorities, is presented in Notes 7, 8 and 12 to the general purpose financial statements.

RISK FINANCING AND PROPRIETARY FUND OPERATIONS

The Commonwealth assumes the risk of loss for property damage and personal injury, breach of contract, condemnation proceedings, and other alleged violations of law and is defended by the Attorney General's Office in such cases. In FY95, approximately \$44.7 million was expended to resolve such claims in special and existing appropriations. Based on the Attorney General's evaluation of cases in which it is probable that a judgment will be rendered against the Commonwealth, and a loss incurred, an additional \$64.4 million has been accrued in the Governmental Funds at June 30, 1995.

The Commonwealth self insures for the State Employee Worker Compensation Program. In FY95, consistent with adoption of GASB statement No.10, the Commonwealth has implemented a new Internal Service Fund within the Proprietary Fund Type. All short and long term assets and liabilities were shifted to the new Fund. As referred to earlier, the Commonwealth has not appropriated funding for accrued expenses for the State Employees Worker Compensation Program. As a result of this "pay as you go" approach, unfunded liabilities totaling \$299.2 million have accumulated. Of this total \$28.4 million will eventually be recovered by chargeback to governmental colleges and universities, and \$270.8 million will require funding by the state.

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In contrast to the internal service operation described above, the Commonwealth, acting through the Executive Office of Transportation and with the approval of the US Department of Transportation, has created a workers compensation insurance program for the Central Artery/Third Harbor Tunnel Project. In this program, annual premiums and investment earnings are accumulated to fund current and future claims and payments. In FY95, again related to GASB statement No.10, the Commonwealth has implemented this as a new Internal Service Fund within the Proprietary Fund Type. The assets on deposit are \$162.4 million offset by estimate liabilities of \$65 million resulting in a positive fund balance of \$97.4 million. In future years as the project matures premiums and other aspects of the Fund will be modified based on claims experience resulting in a closer match between the assets held by the insurance carrier and the estimated liabilities.

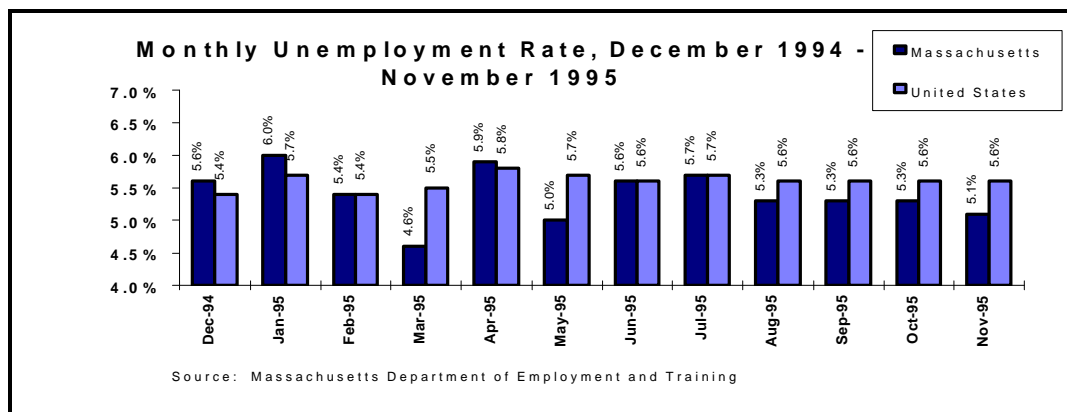
The Group Insurance Commission manages the health insurance program for state employees, retirees and their beneficiaries. Again related to GASB No.10, another Internal Service Fund within the Propriety Fund Type has been established. The accumulated unfunded liability of \$48.5 million was shifted to the new fund.

ECONOMIC AND FINANCIAL PROSPECTS

The Commonwealth of Massachusetts, with an international reputation for medical, cultural, historical and educational institutions, is the economic and educational hub of New England. The Commonwealth's economy remains diversified but it's strongest component is its knowledge-based technology and service industries.

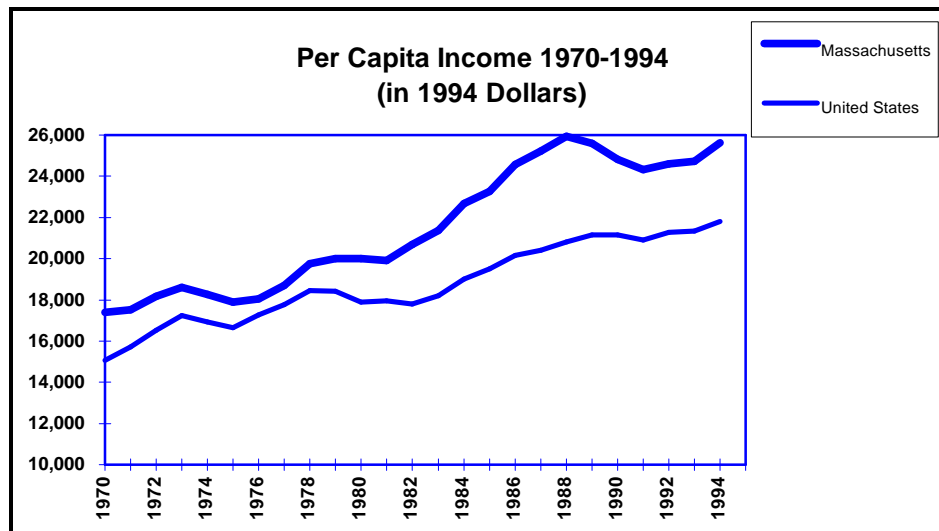
Massachusetts' infrastructure provides strong support for this knowledge-based economy. There are over 120 colleges and universities located in Massachusetts, and 27.2% of the residents over age 25 having earned bachelors degrees, compared to 20.3% for the United States as a whole. Our capital, Boston has 25 hospitals and 3 medical schools. Tourism is a significant component of the economy. The Massachusetts Office of Travel and Tourism estimates that over 25 million visitors spent over \$8.7 billion in the Commonwealth in 1994. The Commonwealth ranked thirteenth among states in exports with \$13.1 billion in 1994.

Massachusetts employment grew 1.6% in 1993 and 2.2% in 1994. The Massachusetts unemployment rate, currently at 5.1%, remains below the national rate of 5.6%.



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Commonwealth per capita income continues to outpace the nation as shown below.



A continued low rate of inflation is expected to keep wage growth low and allow for slow-paced positive growth in the Massachusetts economy.

The Commonwealth's current FY96 budget forecast is consistent with the economic trends presented above. Budgeted revenues and other sources, as estimated by the Executive Office for Administration and Finance, are currently projected at approximately \$16.76 billion. The estimate assumes tax revenues to be approximately \$11.6 billion, or 4.0% above FY95.

The Commonwealth total budgeted expenditures and other uses in FY96 are projected at \$16.94 billion. This estimate assumes the spending in the Commonwealth's seven major programs (Local Aid, Medicaid, Employee Health Insurance, Public Assistance, Debt Service, Pensions and Subsidies to Transit Authorities), which comprise over 66% of budgetary spending, will increase by 3.7% over FY95.

The FY96 opening fund balance on a statutory basis is \$726.0 million. If the FY96 forecast is realized, the ending fund balance will be approximately \$550.0 million. It is noteworthy that, of the \$550.0 million, \$446.4 million is projected to be reserved in the Commonwealth's Stabilization Fund. In this forecast, the Commonwealth has continued a conservative approach. As in past years, ending fund balances may be higher due to this conservative approach to forecasting.

The Administration is currently engaged in an extensive mid-year review of this estimate. Also the Governor has proposed a reorganization of the Executive Branch of State Government. The Governor will release his recommended budget for FY97 and the details of the proposed reorganization in late January, at which time the FY96 forecast may be revised.

SIGNIFICANT ACCOMPLISHMENTS

In FY95, there were a number of significant public policy accomplishments and, on a more operational level, improvements that demonstrate accountability and financial management.

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- The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Commonwealth for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 1994. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports. This is the fifth consecutive year that the Commonwealth has received this award.
- A number of changes in state finance law and automation of budgetary practices were accomplished. Additional attention and disclosure pertaining to revenue is now evident in the budget formulation process. A detailed disclosure of revenue estimates is now institutionalized in the annual General Appropriation Act.
- An ongoing effort to improve the financial accounting and reporting of the non-appropriated funds of public institutions of higher education was successful. Each institution now reports these funds on MMARS, the computerized state accounting system. Additionally, the University of Massachusetts, Massasoit Community College, Holyoke Community College, Bridgewater State College and Massachusetts College of Art are commended for producing stand-alone, audited financial statements in conformity with GAAP.
- A large number of projects to enhance or re-engineer business processes with new technology have been performed. Such projects relate to an array of Commonwealth activities, including automation of welfare eligibility determination, management of cases in the legal system, creating a new statewide client server infrastructure, and significant changes to the Commonwealth's administrative and fiscal systems.

Examples of projects from the domain of financial accounting include: major streamlining of the Commonwealth's cash deposit and non-tax revenue systems; automation of the previously manual functions to exchange cash with the federal government; re-engineering the Commonwealth disbursement practices to the model of electronic commerce, including electronic data interchange, electronic funds transfer, and electronic benefits transfer; implementation of a labor distribution function for cost accounting and control; and creating a data warehouse to make the wealth of data emanating from transaction processing systems accessible and available to knowledge workers via query systems controlled by desktop computers.

A coalition of several departments under the authority of the Governor and across the branches of government are collaborating in joint ventures to leverage resources in these projects. This approach is yielding significant results both in terms of shared functionality and interoperable systems, and increased purchasing power through joint procurements. Exciting partnerships with internal Commonwealth departments and private sector business partners have developed. Recently one of these projects, the Information Warehouse, received national recognition with the "Best Information Warehouse in the United States" Award.

RECOMMENDATIONS AND CONCLUSIONS

The Office of the Comptroller has a unique perspective on state finance based on insights gained through control of day-to-day operations and experience with GAAP. With this background, we take this opportunity to make proposals intended to strengthen state finance.

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- The Commonwealth should enact a program to fund the liability for the State Employee Workers Compensation Program as it is incurred and amortize the accumulated unfunded liability of 299.2 million. This amount did not materialize in a single year and a multi-year funding schedule is recommended. Options to furnish the necessary funding include a “surcharge” to the current statutory chargeback to state agencies, special lump sum appropriations, a redirection of investment earnings, and other actions. Accumulating assets to satisfy the current unfunded liability will be another demonstration of the interperiod equity and sound financial management.
- Regarding financial management, the Office of the Comptroller believes that continued Executive and Legislative attention should be directed to the budgeting and management of non-tax revenues. The Commonwealth should create sophisticated budgeting practices for non-tax revenue, and institutionalize practices for revenue planning, monitoring, and reporting. Current efforts and investments to modernize systems, policies and procedures should be continued. In FY95 the Commonwealth authorized certain incentives for revenue management and a program to optimize tax and non tax revenues. This approach should be continued and expanded.
- Consistent with the prior recommendations, the Office of the Comptroller believes the Commonwealth's current fund structure should be streamlined. The proliferation of budgeted Special Revenue Funds has fractured, not strengthened, the budget process. As special interest groups have enjoyed political success in carving out dedicated revenues and removing operations from the general budget, the capacity for centralized planning and control has diminished. The numerous non-budgeted Special Revenue Funds and Capital Projects Funds further complicate efforts to obtain a comprehensive view of state finance.

Legislation should be enacted to simplify the fund structure, reduce the number of funds to a more manageable number and eliminate all fund deficits. The current practices of "fund splitting" appropriations and interfund transfers should be eliminated.

The definition of a balanced budget, and the terms and conditions for deposits into the Stabilization Fund should be simplified. This would result in a more coherent and understandable picture of the Commonwealth's Governmental Funds financial activity.

- The Commonwealth has a tremendous opportunity to employ new technologies to improve its programmatic, financial, and administrative operations. In FY93 the Governor proposed and the Legislature enacted the Information Technology Capital Outlay Appropriation Act. With this funding the opportunity exists to re-engineer old business practices and engage new client service technology. An unprecedented interdepartmental coalition under the leadership of the Commonwealth's Chief Information Technology Officer creates an exciting opportunity to make strategic investments that will position the Commonwealth successfully into the next century. In FY95, the Governor has proposed a second Information Technology Capital Outlay which is currently under consideration by the Legislature. Enactment of “Information Technology Bond II” is strongly recommended.

In conclusion, this report represents the continued commitment of the Office of the Comptroller to promote quality in the Commonwealth's financial management. I express my sincere appreciation to the dedicated professionals in the Comptroller's Office, especially Martin Benison, BJ Trivedi, and the staff of the Financial Reporting Bureau and other state departments and organizations whose efforts are reflected in this report.

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In addition, the work of the several project teams to implement the Information Technology projects mentioned above is especially noteworthy. You are launched on projects that will create enduring value not only to Massachusetts, but to other states and governments throughout the nation. You exemplify the cutting edge of innovation and the citizens of the Commonwealth are well served by professionals of your caliber.

The Office of the Comptroller transmits the Comprehensive Annual Financial Report for FY95 in accordance with Section 12 of Chapter 7A of the General Laws.

Respectfully transmitted,

William Kilmartin

William Kilmartin
Comptroller